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FEDERAL COMMUNICATIONS COMMISSION
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JAN 10 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Amendment of Parts 32 and 64 of the)
Commission's Rules to Account for)
Transactions between Carriers and Their)
Nonregulated Affiliates)

CC Dkt. No. 93-251

REPLY COMMENTS OF AMERITECH

The Ameritech Operating Companies (Ameritech),¹ pursuant to §§1.415 and 1.419 of the Federal Communications Commission's (Commission) rules, 47 C.F.R. §§ 1.415 and 1.419, respectfully submit the following reply comments, pursuant to the Commission's release of a Notice of Proposed Rulemaking (NPRM) seeking comment on a proposal to significantly change the current cost allocation and affiliate transaction rules.² In these reply comments, Ameritech demonstrates that the Commission's proposed changes will impose significant administrative and cost burdens while not providing any countervailing public interest benefits. Therefore the proposed rules would actually be detrimental to the public interest.

I. The Current Rules Are Sufficient to Achieve the Commission's Objectives

As noted by several commenters, the Commission's objective in adopting the affiliate transaction rules is to prevent cross-subsidization. And, the Commission's affiliate transaction rules have proven to successfully meet this objective. Specifically, since the affiliate transaction rules require LECs to record fully distributed costs (FDC), which includes a rate of return component, for

¹ The Ameritech Operating Companies are: Illinois Bell Telephone Company, Indiana Bell Telephone Co., Inc., Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

² Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and their Nonregulated Affiliates, CC Dkt. No. 93-251, FCC 93-453, 8 FCC Rcd. (released October 20, 1993) (NPRM).

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affiliated service transactions when there is no tariffed rate or prevailing price; in all cases under these rules, ratepayers are assured there is no cross-subsidy.

Moreover, LECs are required to have annual audits of their affiliated transactions conducted by an independent accounting firm. These audits confirm LECs' compliance with their cost allocation manuals and the Commission's rules, during which any audit findings are resolved. Consequently, as the rules are now implemented and enforced, the Commission's objective is clearly met.

Furthermore, the proposed changes to the affiliate transaction rules would impose significant cost and administrative burdens. For example, Coopers & Lybrand, an independent accounting firm, which conducts a number of the annual affiliated interest audits stated that the changes would only add complexity and subjectivity to the affiliate transaction and auditing process. This additional complexity results in a diminishment of the Commission's ability to enforce the rules.³

Several commenters also noted the significant difficulty of obtaining objective and reliable estimated fair market values for service transactions. Specifically, they noted the subjective nature of the fair market evaluation for affiliated service transactions, because of the number of assumptions which must be made about the work being done and the experience of the persons completing the work.⁴ Moreover, they identified substantial costs involved in obtaining the estimated fair market value. For example, AT&T recognizes that the implementation of the proposed rules would be unduly costly and prohibitively expensive.⁵

³ Coopers and Lybrand at 3; see also BellSouth at 17.

⁴ See e.g., Sprint at Attachment 3 at 10-13; and Southwestern Bell at 26.

⁵ See e.g., AT&T at 14-16.

Should the Commission agree with that assessment for AT&T it is equally true for the LECs. The Commission should not impose substantially more restrictive and costly regulatory burdens on the LECs under price caps than on AT&T merely because AT&T does not have sharing. As noted in the comments, the regulatory structure of price caps itself gives LECs substantial incentives to decrease costs which should not be perverted by this overzealous attention to the sharing obligation.⁶

And, since the Commission is scheduled to initiate the price cap review proceeding for LECs this month, at a minimum the Commission should defer the adoption and implementation of these rules until the LEC price cap review is completed.

II. Commenters Supporting the Proposed Rules Provide No Reasonable Basis for Their Adoption

There were a few parties supporting the Commission's proposed rules.⁷ However, in their comments, they only reiterate the conclusions set forth in the NPRM. They provide no independent proof of the need for these changes. For example, ITAA states that the Commission's proposed rules would "significantly enhance the Commission's ability to prevent carriers from imposing the costs of nonregulated activities on ratepayers," without providing a scintilla of proof that such cross-subsidization occurs.⁸ In fact, ICA recognized the lack of sufficient evidence in the Commission's NPRM by recommending that the Commission

⁶ The inconsistency of this argument is evidenced by the comments of NTCA. In that document, NTCA argues that, because the small carriers are rate of return carriers and are not regulated under price caps with the corresponding sharing obligation, the Commission should not impose the new rules on the small LECs.

⁷ See Information Technology Association of America (ITAA); International Communications Association (ICA); and MCI Telecommunications Corp.

⁸ ITAA at 3.

provide more details supporting its conclusions that the current affiliate transaction rules need to be strengthened.⁹

The clear fact is, however, that no such evidence exists. Specifically, the Commission's recent affirmation of its affiliate transaction rules in its Computer III proceeding, together with the annual independent audits of LEC affiliate transactions conclusively demonstrate the effectiveness of the current rules.

Moreover, MCI's attempt to support the Commission's proposed rules similarly fails. Specifically, MCI's reliance on the GAO Report in February 1992 does not provide proof that any of the LECs violated the affiliate transaction rules. Rather, the Report cites current problems with internal Commission staffing and the staff's ability to conduct audits due to its limited resources. The annual independent audit of affiliate transactions addresses that problem.

In addition, MCI's attack of the current prevailing price standard misrepresents both the current standard and LECs' implementation of that standard. In this regard, LECs can use only prevailing price if they have substantial sales to third parties. Ameritech considers both the amount of revenues sold to third parties as well as the number of third party customers in determining whether using prevailing price is appropriate. And, again during the annual independent affiliated interest audit, affiliates using prevailing price must be able to demonstrate third party sales to the auditors. Thus, the manner in which the current prevailing price standard is implemented and enforced provides substantial security that those affiliate transactions occur at a third party price.

Nevertheless, the overwhelming flaw in the comments submitted by these parties is their failure to balance the costs of imposing the proposed rules with

⁹ ICA at 5.

the anticipated public benefits from those rules. In this regard, none of the parties considered the substantial costs of implementing the proposed rules, which were clearly demonstrated in the comments of several LECs.¹⁰ Moreover, none of the parties recognized the impact price cap regulation and competition have on LECs' incentives to prevent cross-subsidization. As noted in Ameritech's comments, the implementation of price caps and the increase in competition for local exchange access services provide overwhelming incentives for LECs to decrease costs -- rather than increase costs -- through affiliate transactions.

In fact, at the same time MCI implores the Commission to significantly increase the regulatory administrative and cost burdens on LECs, it announces its own foray into the local exchange business. Specifically, MCI announced that it intends to enter the local exchange business beginning in 1995 by spending \$2 billion of a \$20 billion capital investment to wire up local access networks in 20 major markets in order to completely bypass the LECs' interstate access services.¹¹ Clearly, the Commission should not impose substantially more restrictive rules on LECs at the behest of a direct competitor like MCI, a \$12 billion company.

III. Conclusion


Based on the foregoing, the commenters in support of the Commission's proposed rules fail to provide any reasoned arguments for adoption of the rules. In addition, as demonstrated by several other parties, there are several developments in the telecommunications industry, in particular price caps and competition, which will ensure just and reasonable access rates. Moreover, the

¹⁰ See e.g., BellSouth at 15-17; GTE at 2-3; and SNET at 8.

¹¹ The Wall Street Journal, Wednesday, January 5, 1994, "MCI Proposes a \$20 Billion Capital Project," at Page A3.

proposed rules would impose a costly and complex regulatory system, which will not more effectively or more efficiently ensure just and reasonable rates. Specifically, there remain substantial questions about the reliability of the estimated fair market value analysis and the inherent inconsistency in the prevailing price test. Finally, the proposed rules will severely limit the efficiencies and economies of scale available under the current rules. Consequently, since the Commission recently affirmed that the current cost allocation and affiliate transaction rules effectively protect the ratepayers, they should be maintained.

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